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PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately financed infrastructure projects

Report of the Secretary-General

Addendum

Chapter I. GENERAL LEGISLATIVE CONSIDERATIONS

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LEGISLATIVE RECOMMENDATIONS

Constitutional issues

(1) It is advisable to review existing constitutional provisions so as to identify possible restrictions to private sector participation in infrastructure development and operation, limitations to the use of public property by private entities and obstacles to private ownership of infrastructure (see paras. 1-4).

Legislative approaches

(2) General enabling legislation may be usefully supplemented by special laws dealing with specific infrastructure sectors. Where sector-specific laws already exist, it is desirable to review them with a view to ascertaining their suitability for privately financed infrastructure projects (see paras. 5-8)

Legislative authority to grant concessions

(3) The law should state clearly the authority of the host Government to award infrastructure projects to the private sector and name those fields of activity or types of infrastructure that may be developed by private entities (see para. 10).

(4) It is advisable for the law to recognize the right of the project company to charge a price for the use of the infrastructure or the service or goods it provides, in accordance with the laws of the country and under the conditions to be provided in the project agreement. It is further advisable for the law to empower the parties to agree on mechanisms for calculating and adjusting those prices (see para. 11).

Legal regime of the project

(5) It may be useful to incorporate into special legislation pertaining to privately financed infrastructure projects those rights and obligations which would otherwise have been applied by implication, and which are found to be appropriate in connection with those projects. The enactment of general enabling legislation may provide an opportunity for excluding the application of those rules of law which are found to pose obstacles to the execution of privately financed infrastructure projects (see paras. 12-15).

Ownership and use of infrastructure

(6) The law should authorize the State to transfer or make available to the project company such public land or existing infrastructure that may be required for the execution of the project (see paras. 16-19).

Legal status of public service providers

(7) It is desirable for the law to authorize the State to grant to the project company the rights, privileges and facilities that are necessary to build and operate the infrastructure and to provide the relevant public services, in its own name or as an agent of the host Government, where the operation of public infrastructure or the provision of public services is reserved to the State (see paras. 20-21).

Administrative coordination

(8) It is advisable for the law to indicate the organs of the host Government, including, as appropriate, national, provincial and local authorities that are authorized to award concessions for infrastructure projects (see paras. 22-23).

(9) The law might entrust one organ with the authority to receive the applications for licences needed for the implementation of infrastructure projects, to transmit them to the appropriate agencies and monitor the issuance of all licences required at the time of the award of the project and other licences that might be introduced thereafter (see paras. 24-26).

(10) The law might also authorize the relevant agencies to issue provisional licences and provide a time period beyond which those licences are deemed to be granted unless they are rejected in writing (see paras. 24-26).

(11) To the extent that the host Government is not in a position to make provisions such as those referred to in (9) and (10) above, it may wish to include in the law a provision requiring the awarding authority to use its best efforts to assist the project company in obtaining the required licences (see para. 27).

Other relevant areas of legislation

(12) In addition to legislation immediately relevant for privately financed infrastructure projects, adequate provisions in other areas of law would facilitate transactions necessary to carry out infrastructure projects and reduce the perceived legal risk of investment in the country (e.g. investment protection law, property law, rules and procedures on expropriation, intellectual property law, security law, company law, accounting practices, contract law, insolvency law, tax law, environmental protection law, settlement of disputes) (see paras. 28-62)

National legislation and international agreements

(13) The host Government may wish to consider the desirability of adhering to international agreements on trade facilitation or agreements on promotion of trade in specific industries and services that would have a positive impact on the implementation of privately financed infrastructure projects (see paras. 63-67).

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. Legal framework for privately financed infrastructure projects

1. Constitutional issues

1. The constitutional law of a number of countries refers generally to the duty of the State to ensure the provision of public services. Some of them list the infrastructure and services sectors which come under the responsibility of the State, while in others the task of identifying those sectors is delegated to the legislator. Under some national constitutions, the provision of certain public services is reserved exclusively to the State or to specially created public entities. Other constitutions, however, authorize the State to award concessions to private entities for the development and operation of infrastructure and the provision of public services. In some countries, there are limitations to the participation of foreigners in certain sectors, or there exist requirements that the State should participate in the capital of the companies providing public services.

2. For countries wishing to promote private investment in infrastructure it is important to review the existing constitutional provisions so as to identify possible restrictions to the implementation of privately financed infrastructure projects. In some countries, privately financed infrastructure projects have been delayed by uncertainties regarding the extent of the State's authority to award them. Sometimes, concerns that those projects might contravene constitutional provisions on State monopolies or on the provision of public services have led to judicial disputes, with negative impact on the implementation of the projects.

3. Another important category of constitutional provisions includes those relating to the ownership of land or infrastructure facilities. The constitutional law of some countries contains limitations concerning private property of land and certain types of means of production. In other countries private property is recognized, but the constitution declares all or certain types of infrastructure to be State property. Prohibitions and restrictions of this nature might be an obstacle to the execution of projects that entail private operation, or private operation and ownership, of the relevant infrastructure.

4. Irrespective of the choice made by the host Government regarding the ownership of infrastructure, it is important for a country wishing to attract private investment in infrastructure to ensure that the State is authorized to make available to the project company such land or existing infrastructure as may be required for the execution of infrastructure projects. In some countries it has been found necessary to amend the constitution so as to provide the State with that authority.

2. General and sector-specific legislation

5. In some countries, as a matter of legislative practice, it has been considered appropriate to adopt specific legislation regulating the execution and operation of one or more individual projects. In other countries with a well-established tradition of awarding concessions to the private sector for the provision of public services, the State is authorized by general legislation to award to the private sector any activity carried out by the public sector which has an economic value that makes such activity capable of being exploited by private entities. General enabling legislation of this type creates a framework for providing a uniform treatment to issues that are common to privately financed projects in different infrastructure sectors. Countries that consider it desirable to adopt general legislation may wish to determine what issues are suitable for being dealt with at this legislative level, and what issues should be left for specific legislation, regulations or for the project agreement.

6. By its very nature, general legislation is normally not suitable to address all the particular requirements of different sectors. In fact, the provision of certain public services is in several countries subject to special legislation governing specific infrastructure sectors (e.g. telecommunications, power generation and distribution, road and railway transportation). One of the arguments in favour of the adoption of sector-specific legislation, even in countries that have adopted general enabling legislation addressing cross-sectoral issues, is that it allows the legislator to take into account the market structure in devising regulatory mechanisms for individual infrastructure sectors.

7. Sector-specific legislation typically sets forth the policy of the Government for the sector concerned, lays down the mechanisms for implementing such policy and provides the general rules for the provision of the relevant services. In many countries, sector-specific legislation was adopted at times when a significant portion, or even the entirety of the national infrastructure constituted State monopolies. Recent national strategies for promoting private sector investment in infrastructure were often based on the results of extensive studies that analysed questions such as the extent of competition that could be introduced in the market as a whole or within specific segments of it, and considered the potential economic costs and expected benefits of abolishing legal monopolies or retaining them in full or in part (see chapter II, "Sector structure and regulation", ___). For countries interested in promoting private sector investment in infrastructure it is advisable to review existing sector-specific legislation so as to ascertain their suitability for privately financed infrastructure projects.

8. Sector-specific legislation may further play an important role in establishing a framework for the regulation of individual infrastructure sectors (see chapter II, "Sector structure and regulation", ___). Legislative guidance is particularly useful in countries at the initial stages of setting up or developing national regulatory capacities. Such guidance is also useful to reassure the lenders and the project consortium that the regulators do not have unlimited discretion in the exercise of their functions, but are bound by the parameters provided by the law. However, it is

generally advisable to avoid rigid or excessively detailed legislation, which in most cases would not be adequate to the long-term nature of privately financed infrastructure projects.

3. Elements for an enabling legislation

9. The implementation of privately financed infrastructure projects may require the enactment of special legislation or regulations authorizing the State to entrust the provision of public services to private entities or decentralized entities wholly or partially owned by the State. Besides being sometimes needed to satisfy national constitutional and other requirements, the enactment of express legislative authorization may be an important measure to foster the confidence of potential private sector investors, national or foreign, in a national policy to promote private sector investment in infrastructure. While it is generally not advisable to attempt to regulate through general legislation specific aspects of the mutual rights and obligations of the project company and the Government, there is a number of core issues that might usefully be addressed in general legislation.

(a) Legislative authority to grant concessions

10. In some legal systems the State is directly responsible for the provision of public services and may not delegate such a function without prior legislative authorization. For those countries that wish to attract private investment in infrastructure, it is therefore particularly important that the law states clearly the authority of the Government to entrust to entities other than governmental agencies the right to provide certain public services and to charge a price for them. For clarity purposes, it is further advisable to identify in such general legislation those fields of activity in which concessions may be awarded.

11. The law should also empower the parties to agree on mechanisms for calculating and adjusting those prices, when they are not established by a regulatory body. Such a general provision in the enabling legislation may be particularly important in those countries where public services are State monopolies, or where it is envisaged to engage private entities to provide certain services that used to be available to the public free of charge. In some countries the absence of prior legislative authorization has given rise to judicial disputes challenging the project company's authority to require the payment of a price for the service provided.

(b) Legal regime of privately financed infrastructure projects

12. In some legal systems belonging to or influenced by the civil law tradition, the provision of public services may be governed by a body of law known as "administrative law", which governs a wide range of State functions. In most of those countries there are well-defined concepts of administrative law that may cover certain forms of infrastructure projects, such as "public works concession", "public services concession", or "delegations", "licences" or "permissions" for the provision of certain forms of public services. Various rights and obligations of the parties may derive from statutory provisions, judicial precedent or general principles of law, according to the

type of the project and the nature of the instrument of award (e.g. whether a bilateral agreement or a unilateral act).

13. In some of those legal systems, for instance, the Government generally has the right to revoke administrative contracts or to modify their scope and terms, for reasons of public interest, usually subject to compensation of loss caused to its contractors, or additional cost incurred by them. Additional rights might include extensive monitoring and inspection rights, as well as the right to impose sanctions on the private operator for failure to perform. In some countries, there are special provisions for the settlement of disputes arising out of Government contracts, and there may be limitations to the right of governmental agencies to agree on non-judicial procedures for settlement of disputes (see chapter XI, "Settlement of disputes", ___). At the same time, some legal systems recognize certain implied conditions in all Government contracts that afford a certain level of protection to Government contractors, such as the right to review the terms of the contract following unforeseen changes in the circumstances (see chapter VIII, "Delays, defects and other failures to perform", ___). In some countries, however, the ability of the Government to revoke or alter the terms under which a private entity provides a public service might be limited to those cases where the relevant instrument was issued in the form of a unilateral act of discretion.

14. The existence of a special legal regime applicable to infrastructure operators and public service providers is not limited to the legal systems referred to above. In several countries belonging to or influenced by the common law tradition there are special rules for each type of public utility (e.g. telecommunications, railways, electricity), which may not always be systematically grouped into a broader body of law. In these countries, too, particular rules have been developed for Government contracts, often through the extensive use of standard forms and terms. Those special rules typically give the Government certain powers of termination or modification balanced by an obligation to indemnify the contractor against the damage sustained by reliance on the contract. In that regard, an important distinction is made in some common law jurisdictions between "franchises", which create vested rights in the public utility to provide the relevant service, from mere "licences", which are personal privileges usually capable of being revoked by the grantor. However, in some countries it is understood that even unilateral acts licensing a private entity to carry out a given activity may create vested rights and, therefore, they may not be changed by the Government without the consent of the private entity, unless such possibility is expressly provided for in the law or in the terms of the licence.

15. In countries where Government contracts are subject to a special regime, it may be advisable for the legislature to review the adequacy of the existing regime for privately financed infrastructure projects and to identify possible difficulties that might result from the application of such a special regime. For purposes of transparency and to avoid any doubts by potential foreign as well as domestic investors, it may be useful to incorporate into special legislation pertaining to privately financed infrastructure projects those rights and obligations that are implied or are not treated systematically in the legal system and which are found to be appropriate in connection with those projects. By the same token, the enactment of general enabling legislation may

provide an opportunity for excluding the application of those rules of law which are found to pose obstacles to the execution of privately financed infrastructure projects.

(c) Ownership and use of infrastructure

16. A number of countries have extensive provisions on the preservation and protection of State property, including special procedures and authorizations required for transferring the title to such property to private entities or granting to private entities the right to use governmental property. Whatever choice is made by the host Government regarding the ownership of the infrastructure facility to be built, modernized or rehabilitated, it is important for a country wishing to attract private investment in infrastructure to authorize the State to transfer or make available to the project company any land or existing infrastructure required for the execution of the project for a period not less than the duration of the project agreement.

17. The ownership regime for a particular project may be the result of practical considerations, such as the operational life of the infrastructure or the interest of the Government in retaining title to it. Moreover, in some projects the parties may wish to distinguish between assets that are to be owned by or reverted to the Government at the end of the concession period, and other assets acquired by the project company during that period and which remain the project company's property. In some countries the law expressly provides that title to all assets originally furnished by the host Government for the construction of the facility, and to the facilities and improvements built thereafter by the project company, is vested in the host Government throughout the duration of the agreement. Some laws, on the other hand, authorize the transfer to the project company of title to the property required for the purposes of the concession or provide that the project company will own all assets that are acquired as a result of the concession. Other laws, while not authorizing the transfer of title to the project company, provide for some other rights *in rem* and provide in detail for their nature and scope (e.g. leasehold, right to use, usufruct).

18. Whatever form its rights may take, for the project company it is important to be assured that they are based on sufficient legislative authority and that it will be able to enforce them against third parties. The same concern will be shared by the lenders and other project investors. Furthermore, in view of the legal restrictions that apply in many countries to the use of public property by private entities, the Government may necessitate prior legislative authorization to allow the project company to use any additional public property.

19. Therefore, it might be desirable for the relevant legislation to clarify the nature of the property rights, if any, that may be granted to the project company, taking into account the type of infrastructure concerned. Furthermore, it might be useful for the law to authorize the Government to grant to the project company the right to use land, roads and other supporting facilities not directly related to the project, as required for the construction and operation of the infrastructure, under the terms and conditions to be provided in the project agreement.

(d) Legal status of public service providers

20. Public agencies or State organs providing public services are typically entrusted with powers designed to facilitate the provision of the service and to ensure that the users comply with and observe the pertinent regulations and rules. This may include, for instance, the right to issue, or control compliance with, safety regulations and the right to suspend the provision of service for emergency or safety reasons or because of default or non-compliance by the users (see chapter VII, "Operational phase", ___). Those powers typically derive from the overall authority of the State and in some legal systems they are inherently governmental.

21. In countries with a well established tradition of awarding concessions for the provision of public services, the concessionaire is typically entrusted with the necessary powers by a delegation of authority from the State. The extent of powers delegated to the concessionaire is usually defined in the project agreement and may not need to be provided in detail in general enabling legislation of the type discussed in the *Guide*. However, where the operation of public infrastructure or the provision of public services is reserved to the State, it is desirable for the law to provide the State with the general authority to grant to the project company the rights, privileges and facilities that are necessary to build and operate the infrastructure and to provide the relevant public services, in its own name or as an agent of the host Government.

4. Administrative coordination

22. Depending on the administrative structure of the host country, privately financed infrastructure projects may require the involvement of several different governmental agencies, at various levels of Government. For instance, the competence to lay down regulations and rules for the activity concerned may rest in whole or in part with a governmental agency at a level different from the one that is responsible for providing the relevant service. It may also be that both the regulatory and the operational functions are combined in one entity, but that the authority to award Government contracts is centralized in a different governmental agency. For projects involving foreign investment, it may also happen that certain specific competences may fall within the mandate of the agency of the host Government that is responsible for approving foreign investment proposals.

23. Where general enabling legislation is adopted, it is advisable to indicate clearly the agencies or levels of government competent to award infrastructure projects to the private sector. It may be useful to consider the extent of powers that may be needed by authorities other than the central Government to carry out projects falling within their purview. General legislation may itself provide the procedures for identifying or prioritizing infrastructure projects to be awarded to the private sector or it may refer to the rules that will establish those procedures. Similarly, the legislation may provide the procedures to be followed for the selection of the concessionaire, or indicate under which rules the selection is to be carried out (see further chapter III, "Selection of the concessionaire").

24. In addition to clarifying matters relating to the overall authority to award projects in a specific sector, the legislation may play a useful role in facilitating the issuance of approvals and licences that may be needed in the course of a project (such as licences under foreign exchange regulations; licences for the incorporation of the project company; authorizations for the employment of foreigners; registration and stamp duties for the use or ownership of land; importation licences for equipment and supplies; construction licences; licences for the installation of cables or pipelines; licences for bringing the facility into operation; spectrum allocation for mobile communication). The required licences and authorizations may fall within the competence of various organs at different levels of the national administration and the time required for their issuance may be significant, particularly when the approving organs or offices were not originally involved in conceiving the project or negotiating its terms.

25. By the time the project agreement is signed, the project consortium will normally have spent considerable time and invested significant sums in the project (e.g. preparation of feasibility studies, engineering design and other technical documents; preparation of tendering documents and participation in the tendering proceedings; negotiation of the project agreement, loan agreements and other project-related contracts agreements; hiring consultants and advisers). The possibility of not obtaining the licences needed for the construction of the facility may dissuade serious investors from competing for the award of the project. Furthermore, delay in bringing an infrastructure project into operation as a result of failing licences is likely to compromise the project's financial viability or cause considerable loss to its sponsors. Where the additional financial cost cannot be recovered by means of an extension of the concession period, or by raising the tariffs or charging higher prices, the project company might turn to the host Government for redress or support. The consequence would often be an increase in the cost of the project and in its cost to the public.

26. An early assessment of licences needed for a particular project may significantly contribute to avoiding delay in the implementation phase. A possible measure to enhance the coordination in the issuance of licences and approvals might be to entrust one organ with the authority to receive the applications for licences, to transmit them to the appropriate agencies and monitor the issuance of all licences listed in the request for proposals and other licences that might be introduced by subsequent regulations. The law may also authorize the relevant agencies to issue provisional licences and provide a time period beyond which those licences are deemed to be granted unless they are rejected in writing.

27. However, there might be instances where the host Government, for constitutional or other reasons pertaining to its internal organization, might not be in a position to assume responsibility for the issuance of all licences or to entrust one single body with such a coordinating function. In that case, the host Government might wish to consider providing some assurance that nevertheless it will as much as possible assist the project company in obtaining licences required by national law, for instance as by designating an office or agency dedicated to provide information and assistance to project consortia regarding the required licences to be obtained, as well as the relevant procedures and conditions.

B. Other relevant areas of legislation

28. In addition to issues pertaining to legislation immediately relevant for privately financed infrastructure projects, a favourable legal framework may include provisions in other areas of legislation. Private investment in infrastructure would be encouraged by the existence of legislation that promotes private investment in economic activities. The following paragraphs point out only a few selected aspects of other fields of law that may have an impact on the implementation of infrastructure projects.1/ The existence of adequate legal provisions in these other fields may facilitate a number of transactions necessary to carry out infrastructure projects and to reduce the perceived legal risk of investment in the country.

1. Investment protection

29. One matter of particular concern for the project consortia and the lenders is the degree of protection afforded to investment in the host country. The confidence of investors in the host country may be fostered, for example, by protection from nationalization or dispossession without judicial review and appropriate compensation. Companies participating in project consortia will also be concerned about their ability, *inter alia*, to bring to the country without unreasonable restrictions the qualified personnel required for working with the project, to import needed goods and equipment, to have access to foreign exchange as needed, transfer abroad or repatriate their profits.

30. For countries that already have adequate investment protection legislation, it may be useful to consider expressly extending the protection provided in such legislation to private investment in infrastructure projects.

31. In addition to adopting domestic legislation on investment protection, an increasing number of countries have entered into bilateral investment agreements which aim at facilitating and protecting the flow of investment between the contracting parties. Investment protection agreements usually contain provisions concerning the admission and treatment of foreign investment; transfer of capital between the contracting parties (e.g. payment of dividends abroad, repatriation of investment); availability of foreign exchange for transfer or repatriation of proceeds of investment; protection from expropriation and nationalization and settlement of investment disputes. The existence of such an agreement between the host country and the originating country or countries of the members of the project consortium may play an important

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1/ For a general overview of the legal framework required for fostering private investment in privatized sectors, see United Nations Conference on Trade and Development (UNCTAD), *Comparative Experiences with Privatization*, New York and Geneva, 1995, pp.40-52. Particularly in respect of economies in transition, see United Nations Economic Commission for Europe, *Legal Aspects of Privatization in Industry*, New York, 1992, pp. 13-30.

role in their decision to invest in the host country. Depending on its terms, such an agreement may reduce the need for assurances or guarantees by the Government geared to individual infrastructure projects.

32. A multilateral agreement on investment is currently being negotiated under the auspices of the Organization for Economic Cooperation and Development (OECD). The OECD multilateral agreement on investment is intended to deal with dispute settlement, protection of investors and investments, liberalization, privatization and monopolies, key personnel, environment and labour issues, performance requirements, investment incentives.

2. Property law

33. It is desirable that the property laws of the host country reflect modern acceptable standards and contain adequate provisions on the ownership and use of land and buildings, as well as moveable and intangible property (e.g. copyrights), and ensure the project company's ability to purchase, sell, transfer and license the use of property, as appropriate.

34. Whether the project company owns the land on which the facility is built, or is only granted a right to use it, it is important that the ownership of the land can be clearly and unequivocally established through adequate registration and publicity procedures. The project company and lenders will need reasonable proof that ownership of the land will not be subject to dispute. They will therefore be reluctant to commit funds to the project if the laws of the host country do not provide adequate means for ascertaining ownership of the land. It is also desirable to ensure that the project company will be able to create security interest on such property, for the purpose of obtaining financing for the project (see chapter IV, "Conclusion and general terms of the project agreement", paras. 39-45).

35. It is further necessary to provide effective mechanisms for the enforcement of the property and possessory rights granted to the project company against violation by third parties. Enforcement should also extend to easements and rights of way that may be needed by the project company for providing and maintaining the relevant service (e.g. placing of poles and cables on private property to ensure the distribution of electricity) (see chapter IV, "Conclusion and general terms of the project agreement", paras. 13-16).

3. Rules and procedures on expropriation

36. Usually the host Government assumes the responsibility for providing the land required for the implementation of the project, which may be either purchased from its owners, or, if necessary, acquired through expropriation (see chapter IV, "Conclusion and general terms of the project agreement", paras. 8-12). Many countries have legislation governing expropriation procedures and that legislation would apply to any expropriation required for privately financed infrastructure projects.

37. Expropriation procedures are usually lengthy and complex. They may also involve a number of offices at different ministries or levels of Government. Particular delay may be encountered in some countries where the expropriation takes the form of court proceedings. The host Government might thus wish to review existing provisions on expropriation for reasons of public interest with a view to assessing their adequacy to the needs of large infrastructure projects and to determining whether such provisions allow quick and cost-effective procedures, with due consideration to the rights of the owners. It is particularly important to enable the host Government to take possession of the property as early as possible, so as to avoid start-up delay and increased project costs (see chapter VIII, "Delays, defects and other failures to perform", ___).

4. Intellectual property law

38. Privately financed infrastructure projects frequently involve the use of new or advanced technologies protected under patents or similar intellectual property rights. They may also involve the formulation and submission of original or innovative solutions, which may constitute the proponent's proprietary information under copyright protection. Private investors, national and foreign, bringing new or advanced technology into the country or developing original solutions, will need to be assured that their intellectual property rights will be protected and that they will be able to enforce those rights against infringements.

39. A legal framework for the protection of intellectual property may be provided by adherence to international agreements regarding the protection and registration of property rights. *[The Commission may wish to consider whether a list of the main international instruments and a brief description of their contents, which could be prepared in consultation with the World Intellectual Property Organization (WIPO), should be inserted in this paragraph.]*

5. Security law

40. The type and extent of security offered by the project company or its shareholders will play a central role in the contractual arrangements for the financing of infrastructure projects. The security arrangements may be complex and consist of a variety of forms of security, including fixed security over physical assets of the project company (e.g. mortgages or charges), pledges of shares of the project company and assignment of receivables of the project. While the loan agreements are usually subject to party autonomy as to the law applicable to them, the laws of the host country will in most cases determine the type of security that can be enforced against assets located in the country and the remedies available. Differences in the type of security or limitations in the remedies available under the laws of the host country may be a cause of considerable practical difficulties. It is therefore important to ensure that domestic laws provide adequate legal protection to secured creditors and do not hinder the ability of the parties to establish appropriate security arrangements.

41. Basic legal protection may include provisions ensuring that fixed security (e.g. a mortgage) is a registrable interest and that, once such security is registered in the central register of title or other public register, any purchaser of the property to which the security attaches should take the property subject to such security. Furthermore, security should be enforceable against third parties, have the nature of a property right and not a mere obligation and should entitle the person receiving security to a sale, in enforcement proceedings, of the assets taken as security. Secured creditors should enjoy preference to unsecured creditors in insolvency proceedings.

42. Another important aspect concerns the flexibility given to the parties to define the debt or debts which are secured and the assets which are given as security. In some legal systems, broad freedom is given to the parties in the definition of assets that may be given as security. In some legal systems, it is possible to create security that covers all the assets of an enterprise, making it possible to sell the enterprise as a going concern, which may enable an enterprise in financial difficulties to be rescued while increasing the recovery of the secured creditor. Other legal systems, however, allow only the creation of security that attaches to specific assets and do not recognize security covering the entirety of the debtor's assets. There may also be limitations on the debtor's ability to trade in goods given as security. The existence of limitations and restrictions of this type makes it difficult or even impossible for the debtor to create security over generically described assets or over assets traded in the ordinary course of its business.

43. Given the long-term nature of privately financed infrastructure projects, the parties may wish to be able to define both the debt or debts which are secured and the assets which are given as security specifically or generally. They may further wish such security to cover present or future assets and assets which might change during the life of the security. It may be desirable to review existing provisions on security interests with a view to including provisions enabling the parties to agree on suitable security arrangements.

44. Another form of security typically given in connection with certain privately financed infrastructure projects is an assignment to lenders of proceeds from contracts with customers of the project company. Those proceeds may consist of the proceeds of a single contract (e.g. a power purchase commitment by a power distribution entity) or of a large number of individual transactions (e.g. monthly payment of gas or water bills). In most cases it would not be practical for the project company to specify individually the receivables being assigned to the creditors. Therefore, assignment of receivables in project finance typically takes the form of a bulk assignment of future receivables. However, there may be considerable uncertainty in various legal systems with regard to the validity of the wholesale assignment of receivables and of future receivables.

45. Thus far, no comprehensive uniform regime or model for the development of domestic security laws has been elaborated by international intergovernmental bodies. A model for the development of modern legislation on security interests is offered in the Model Law on Secured Transactions, which was prepared by the European Bank for Reconstruction and Development

(EBRD) to assist legislative reform efforts in central and eastern European countries.2/ Besides general provisions on who can create and who can receive a security right, and general rules concerning the secured debts and the charged property, the EBRD Model Law on Secured Transactions covers other matters, such as the creation of security rights, the interests of third parties, enforcement of security and registration proceedings. The solutions proposed in the EBRD Model Law on Secured Transactions are intended to achieve the objectives discussed in paragraphs 41-44 above. *[A description of the work done by UNCITRAL in the field of assignment of receivables might be inserted in this paragraph, at the appropriate stage.]*

6. Company law

46. In most projects involving the development of a new infrastructure, the members of the project consortium will establish the project company as a separate legal entity in the host country (see chapter IV, "Conclusion and general terms of the project agreement", paras. ___). It is therefore important for the host Government to have adequate company laws with modern provisions on essential matters such as establishment procedures, corporate governance, issuance of shares and their sale or transfer, accounting and financial statements and protection of minority shareholders.

47. The project company's shareholders are interested in limiting their liability to the value of their shares in the company's capital. If it is intended that the project company will offer shares to the public, limited liability will be necessary, as the prospective investors will usually only purchase those shares for their investment value and will not be closely involved in the operation of the project company. It is therefore important that the laws of the host country provide adequately for the limitation of liability of shareholders. Furthermore, adequate provisions governing the issuance of bonds, debentures or other securities by commercial companies will enable the project company to obtain funds from investors on the security market, thus facilitating the financing of certain infrastructure projects.

48. Modern company laws often contain specific provisions regulating the conduct of managers so as to prevent conflicts of interest. Provisions of this type require that managers act in good faith in the best interest of the company and do not use their position to foster their own or other person's financial interests to the detriment of the company. Provisions intended to curb conflicts of interests in corporate management may be particularly relevant in connection with infrastructure projects, where the project company may wish to engage its own shareholders, at one or the other stage of the project, to perform works or provide services in connection therewith (see chapter VI, "Construction phase", ___).

2/ European Bank for Reconstruction and Development, *Model Law on Secured Transactions*, London, 1994.

49. It is important for the law to regulate adequately the decision-making process both for meetings of the shareholders and meetings of management organs of the company (e.g. board of directors or supervisory board). Protection of shareholders' rights and in particular protection for minority shareholders from abuse by controlling or majority shareholders are important elements of modern company laws. It is useful to recognize the right of the shareholders to regulate a number of additional matters concerning the management of the project company through agreements among themselves.

7. Accounting practices

50. The adoption of standard accounting practices is a measure taken in many countries so as to achieve uniformity in the valuation of businesses. The use of modern and internationally acceptable accounting practices may be instrumental for ensuring the marketability of bonds and other security issued by the project company for the purpose of raising funds in international financial markets. In connection with the selection of the concessionaire, the use of standard accounting practices may also facilitate the task of evaluating and comparing proposals and establishing which proposal offers best value for money over the entire concession period (see chapter III, "Selection of the concessionaire", paras. 75-77). Standard accounting practices are further essential for carrying out audits of the profits of companies, which may be required for the application of tariff structures and the verification of compliance by the regulatory body (see chapter VII, "Operational phase", ___).

8. Contract law

51. It is important that the domestic law on commercial contracts provide adequate solutions to the needs of the project company and the lenders, including flexibility in devising contracts as needed for the construction and operation of the infrastructure facility. Besides some essential elements of adequate contract law, such as general recognition of party autonomy, judicial enforceability of contract obligations and adequate remedies for breach of contract, the laws of the host country may create a favourable environment for privately financed infrastructure projects by facilitating contractual arrangements likely to be used in these projects.

52. Where a new infrastructure is to be built, the project company may need to import large quantities of supplies and equipment. Greater legal certainty for those transactions may be facilitated if the laws of the host country contain provisions specially adapted to international sales contracts. A particularly suitable legal framework may be provided by adherence to the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) or other international instruments dealing with specific contracts, such as the UNIDROIT Convention on International Financial Leasing (Ottawa, 1988).

9. Insolvency law

53. The insolvency of an infrastructure operator or public service provider raises a number of issues that have led some countries to establish special rules to deal with those situations,

including rules that enable the host Government to take the measures required to ensure the continuity of the project (see chapter IX, "Duration extension and early termination of the project agreement", ___). Of particular concern for the secured lenders will be provisions concerning secured claims, particularly as to whether secured creditors may foreclose on the security despite the opening of insolvency proceedings, whether secured creditors are given priority for payments made with the proceeds of the security and how claims of secured creditors are ranked.

54. The insolvency of a project company is likely to involve creditors from more than one country or affect assets located in more than one country. It may therefore be desirable for the host country to have provisions in place that facilitate judicial cooperation, court access for foreign insolvency administrators and recognition of foreign insolvency proceedings. A suitable model that may be used by States wishing to adopt legislation for that purpose is provided in the UNCITRAL Model Law on Cross-Border Insolvency.3/

10. Tax law

55. The general taxation regime of the host country plays a significant role in the investment decisions of private companies. Beyond an assessment of the impact of taxation in the project cost and the expected margin of profit, private investors consider questions such as the overall transparency of the domestic taxation system, the degree of discretion exercised by taxation authorities, the clarity of guidelines and instructions issued to taxpayers, the objectivity of criteria used to calculate tax liabilities.

56. Some countries, particularly developing countries and economies in transition, have made use of tax incentives to attract foreign investment or to promote investment in specific industries or regions. Common types of tax incentives may include reduced corporate income tax, exemption from income tax for foreign personnel required to staff the project, exemption from real estate tax, and tax concession on royalties or import duties. It should be noted, however, that project-specific tax incentives in the form of waivers or reductions of particular taxes, special tax withholding or deduction schemes or other ad hoc deviations from the general taxation regime of the host country are potentially discriminatory and may be less transparent than more direct forms of governmental support to the project (see chapter V, "Government support", paras. ___). Furthermore, it may be advisable for national Governments to review extensive tax incentives to foreign enterprises, particularly those which are indefinite and awarded to all kinds of foreign investment, since their continuation might put domestic investors at an unfair competitive disadvantage.

3/ The text of the Model Law was adopted by the Commission at its thirtieth session (Vienna, 12-30 May 1997) and is set forth in annex I to the report of UNCITRAL on the work of its thirtieth session (*Official Records of the General Assembly, Fifty-second Session, Supplement No. 17* (A/52/17)).

57. One particular problem of privately financed infrastructure projects involving foreign investment is the possibility that foreign companies participating in a project consortium might be exposed to double taxation, i.e. taxation of profits, royalties and interests in their own home countries as well as in the host country. A number of countries have entered into bilateral agreements to eliminate or at least reduce the negative effects of double taxation, and the existence of such agreements between the host country and the home countries of the consortium members often plays a role in their tax considerations.

11. Environmental protection

58. Environmental protection laws are likely to have a direct impact on the implementation of infrastructure projects at various levels. Environmental protection laws often require prior authorization for the exercise of a number of business activities, which may be particularly stringent for some types of infrastructure (e.g. waste water treatment, waste collection). Authorizations and licences are often required for undertaking construction works or for installing certain physical structures. The denial of an environmental licence may in some cases constitute an impediment to the execution of the whole project.

59. Therefore, it is advisable to ensure the highest possible degree of clarity in provisions concerning the tests that may be applied by the environmental authorities, the documentary and other requirements to be met by the applicants, the conditions under which licences are to be issued, the circumstances that justify the denial or withdrawal of a licence and the appeals procedures and judicial remedies, as appropriate, that are available to the applicants. It may be further advisable to ascertain to the extent possible, prior to the final award of the project, whether the conditions for obtaining such a licence are met (see paras. 22-27). In some countries, special governmental agencies or advocacy groups may have a right to institute legal proceedings to seek to prevent environmental damage, which may include the right to seek the withdrawal of a licence deemed to be inconsistent with applicable environmental standards. In some of those countries it was found useful to involve representatives of the public in the proceedings that lead to the issuance of environmental licences.

60. Further issues under the host country's environmental laws may arise when the project company takes over an existing infrastructure facility, in particular where the question of responsibility for environmental damage caused by State-owned industry prior to privatization has not been clarified. Private investors may be reluctant to take over an existing infrastructure or purchase shares in public utilities which may be called upon in the future to compensate for or remedy environmental damage caused by the enterprise before it was privatized. It may therefore be advisable to establish mechanisms for compensating the private investors for liability incurred as a result of environmental damage caused during the period of State operation.

12. Settlement of disputes

61. Another important factor for the implementation of privately-financed infrastructure projects is the legal framework in the host country for the settlement of disputes (see chapter XI, "Settlements of disputes", __). Investors, contractors and lenders may be encouraged to participate in projects in countries that provide a hospitable and internationally acceptable legal climate for the settlement of disputes, as offered by the UNCITRAL Model Law on International Commercial Arbitration. The efficiency of the national judicial system, the expeditiousness of court proceedings and the availability of forms of judicial relief that are adequate to commercial disputes are additional factors to be taken into account. Of particular importance is the possibility of recognition and enforcement of foreign arbitral awards, which will be fostered by adherence to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958).

62. A framework for the settlement of disputes between the host Government and foreign companies participating in a project consortium (see chapter XI, "Settlement of disputes", ___) may be provided by adherence to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (Washington, 1965). The Convention, which has thus far been adhered to by 139 States, established the International Centre for the Settlement of Investment Disputes (ICSID). ICSID provides facilities for the conciliation and arbitration of disputes between member countries and investors who qualify as nationals of other member countries. Recourse to ICSID conciliation and arbitration is voluntary. However, once the parties to a contract or dispute have consented to arbitration under the ICSID Convention, neither can unilaterally withdraw its consent. All ICSID members, whether or not parties to the dispute, are required by the Convention to recognize and enforce ICSID arbitral awards. ICSID is an autonomous international organization with close links with the World Bank.

C. National legislation and international agreements

63. In addition to the internal legislation of the host country, privately financed infrastructure projects may be affected by international agreements entered into by the host country. The implications of certain international agreements is briefly discussed below.

1. General agreements on trade facilitation and promotion

64. A number of multilateral agreements have been negotiated to promote free trade at the global level. The most notable of those agreements have been negotiated under the auspices of the General Agreement on Tariffs and Trade (GATT), and later the World Trade Organization (WTO). Those agreements may contain general provisions on trade promotion and facilitation of trade in goods (e.g. a most-favoured nation clause, prohibition of the use of quantitative restrictions and other discriminatory trade barriers) and on the promotion of fair trade practices (e.g. prohibition of dumping and limitations on the use of subsidies). Some specific agreements are aimed at the removal of barriers for the provision of services by foreigners in the contracting

States or promoting transparency and eliminating discrimination of suppliers in public procurement. Those agreements may be relevant for national legislation on privately financed infrastructure projects which contemplates restrictions on the participation of foreign companies in infrastructure projects, or establishes preferences for national entities, or for the procurement of supplies in the local market.

2. International agreements on specific industries

65. The telecommunications sector to date is governed by specific international commitments on matters of market structure, competition and regulation. In the context of the negotiations on basic telecommunications concluded as part of the General Agreement on Trade in Services (GATS), a number of World Trade Organization (WTO) member States representing most of the world market for telecommunication services have made specific commitments to facilitate trade in telecommunication services. Other WTO member countries may still file specific commitments, those that already made them may offer improvements at any time, whereas new WTO members may be asked as part of the adhesion negotiations to include specific telecommunications commitments.

66. It should be noted that all WTO member States (even those that have not made specific telecommunications commitments) are bound by the general GATS rules on services, including specific requirements dealing with most-favoured-nation treatment, transparency, regulation, monopolies and business practices. The WTO telecommunications agreement adds sector-and country-specific commitments to the overall GATS agreement. Typical commitments cover the opening of various segments of the market, including voice telephony, data transmission and enhanced services, to competition and foreign investment. Legislators of current or prospective WTO member States would thus ensure that the country's telecommunications laws are consistent with the GATS agreement and their specific telecommunications commitments.

67. Another important sector-specific agreement at the international level is the Energy Charter Treaty, concluded at Lisbon on 17 December 1994 and in force since 16 April 1998, which has been enacted to promote long-term cooperation in the energy field. The Treaty provides various commercial measures like the development of open and competitive markets for energy materials and products, the facilitation of transit and the access to and transfer of energy technology. Furthermore, the Treaty aims at avoiding market distortions and barriers to economic activity in the energy sector and promotes the opening of capital markets to encourage the flow of capital in order to finance trade in economic materials and products. The treaty also contains regulations about investment promotion and protection: equitable conditions for investors, monetary transfers related to investments, compensation for losses owing to war, civil disturbance or other similar events, and compensation for expropriation.

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